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LATE BREAKING DEVELOPMENTS

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- This panel discussion will deal with recent regulations, revenue rulings, and current topics. The Tax Reform Act of 1986 (TRA 86) regulations are expected to take up a significant portion of the session.

MR. WAYNE E. DYDO: There are many developments in the employee benefits area, but most of what we are looking for is late, and there are very few late breaking developments. It would be a pleasure to present to you new regulations on, for example, minimum coverage and participation or integration under TRA 86, but unfortunately they are not manifest yet. So, we have created a program dealing with published IRS guidance, legislation in process, current developments under the new Pension Protection Act, and finally, what to anticipate from the IRS in the next several months.

Our first speaker is Seth Tievsky. Seth is an attorney with The Wyatt Company's Research and Information Center working out of Washington, D.C. He is an active member of the Employee Benefits Committee of the American Bar Association's section on taxation. He is admitted to the bar here in California as well as the District of Columbia and he holds a law degree from UCLA. He has been engaged in the active practice of benefits law in Washington, D.C., since 1975.

His work involves frequent contact with policymakers at the IRS, the Department of Labor (DOL), and the Pension Benefit Guaranty Corporation (PBGC). Seth worked from 1975 through 1979 as an attorney with the PBGC's Office of General Counsel.

MR. SETH H. TIEVSKY: I'm going to be focusing primarily on upcoming benefits legislation. Some of this is very hot right now, while other items are things that we probably won't see for a few years yet that are clearly in the hopper on Capitol Hill. Technical corrections have been reintroduced once again for the TRA 86 just this past week.

This is the third time in the past year that bills have been introduced. The problem has been that the congressional leadership has not been able to be sure

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they'll be able to get a clean technical corrections bill through Congress. Most of the congressmen want to jump on this opportunity of another tax bill to try to get favorable tax relief for one of their constituents. So it's questionable whether or not even these new bills will pass Congress this year; as recently as last week, it was rated as a toss-up by some of the leading staffers on the tax writing committees for 1988. In the meantime, the IRS is indicating, on an item-by-item basis, that in some cases you can rely on the technical corrections even though they have not been enacted yet, while in other cases (for example, the problem with the minimum participation transition rule under 401(a)(26)), you cannot rely on the technical corrections until they have been enacted. I believe that such enactment is only a toss-up for this year.

The first bill that I want to talk about deals with the topic of defined benefit asset reversions. Current status, of course, is that reversions are only permitted on plan termination. There is a 10% excise tax on the amount going to the employer unless it's transferred into an Employee Stock Ownership Plan (ESOP). Participants' benefits have to be annuitized under the joint implementation guidelines, and since ERISA was passed you've had to share some of the excess assets with participants who had made mandatory contributions to the plan. That last consideration was changed with the Pension Protection Act under the Omnibus Budget Reconciliation Act of 1987 (OBRA 87), which required the Plan sponsor to expand the amount that had to be attributed to mandatory employee contributions.

At this point though, a moratorium has been proposed. A bill has been introduced in the House, and a companion bill will be introduced in the Senate very shortly, which would impose a moratorium on all plan asset reversions where the notice of intent to terminate was filed on or after 1989. This is structured so that it does not disturb the underlying termination, but it does prohibit plan assets from being transferred to the employer at the end of the termination; if such a transfer were made, the plan fiduciaries would be deemed to have engaged in a prohibited transaction. Two alternatives exist for the plan: (1) distribute all the assets to the participants, or (2) set up a trust to which the assets are transferred (they would be held in this trust until the expiration of a moratorium in October 1989). The kicker here is that by October 1989, the drafters of this legislation are hoping they'll have in place some more stringent requirements on sharing surplus assets with employees. So this is really a stop-gap measure, proposed to address the fear that plan sponsors are going to try to make a rush for the door and terminate their plans for reversions now before the legislators are able to get their final legislation in place.

It's difficult to say what's going to happen with this proposal. The House Education and Labor Committee (HELC) is pushing it pretty hard. I understand the Senate, through Senator Metzenbaum and a few others, will be also pushing on this. There are a number of cosponsors to the bill, but this is an election year, and it's difficult to say what's going to pass and what won't. The key is whether or not it can be attached to some other legislation. If you talk to people on the HELC, staffers there feel that it's virtually a certainly, while if you talk to some of the others (for instance, members of the tax writing committees), they're not nearly as sure. If it is passed, even the terminations that you have in process now, if the notices were filed after March 8 of this year, would be affected.

Regarding the reversion issue generally, beyond the moratorium, the proposals that are being discussed are of two types. From the Education and Labor side

in the House is the proposal to share reversions with the employees, with the intent being that 125% of the plan's termination liabilities would go to the employees and once past that 125% threshold the remainder would go to the employer. Tax writing committees take issue with this, though, and their ideas are more on a traded basis, with reversion amounts depending on the type of plan, if any, that would be established in place of the terminated defined benefit plan. If there's a termination/reestablishment and the reestablished plan is at least as good as the terminated plan, then 10% of the reversion would go to the employees. If a new plan is established which is not as good as the old defined benefit plan, or as a defined contribution plan, then some graded basis between 10% and 40% of the excess would go to the employees. If no successor plan is established, then 40% would go to the employees.

There is a further proposal that is being pushed by Education and Labor (and that was also contained in the administration's proposals that were issued last spring) which would allow employers of ongoing plans to make withdrawals from those plans, as long as the plans are funded at at least 125% of termination liabilities.

As far as a prediction for the legislation to share surplus with employees, it's likely that we will have a change in the law at some point probably in the next year or two. It's an item that has a lot of interest on Capitol Hill; it's simply a matter of finding the right piece of legislation to which it could be attached. It's being pushed very hard by HELC, as well as the Senate Labor Committee. I think within the next couple of years we'll have something there.

The next piece of legislation that is very immediate is Medicare catastrophic coverage. This is important to employers who maintain a retiree health plan, since this legislation would expand coverage under Medicare, thereby decreasing the amount of coverage that would have to be provided under the employer's plan. Basically, this is the largest expansion of Medicare since Medicare was enacted in 1965. There would be a limit on the beneficiary liability for inpatient hospitalization, for skilled nursing facility care, and basically for all current services that are now provided under Medicare. Under the Senate version, the limit would be $1,850 a year, while under the House version it would be $1,623 a year. There would also be a new prescription drug program that would be available under Medicare part B. To pay for this, there would be an increase in Medicare premiums; this increase would be between $1 and $4, depending on the bill under consideration, and this additional premium would increase if prescription drug coverage was elected. There would also be a supplemental premium for individuals to the extent that their income is above a certain threshold.

According to the Congressional Budget Office, their projection of average savings would be $120 per year per person in 1989. Since actual savings depend on the extent of the employer's coverage and past experience, that's really a rough number. If an employer provides prescription drug coverage, then there would be additional savings there since that would be available under Medicare part B. If an employer already pays or reimburses former employees for Medicare part B premiums, the savings would be a lot less because part B premiums will increase by about $83 a year. Even though it looks like employers may have a windfall here, somebody picked that up in Congress and is going to try to fix it. An amendment was added to the Senate version of Medicare catastrophic coverage that requires that the savings be passed on to the individuals, basically in order to offset the premium increase to the individuals. This would be for one year only, although it's really not clear that Congress would stick to

simply a one-year pass-on of the savings. What would be required would be one of two things: (1) the employers would pay over the savings directly to the individuals, or (2) the employer could increase the coverage under the retiree health plan by an amount actuarially equivalent to the savings that the employer would be receiving. These bills are in conference now. They passed both the House and Senate last fall, and had been hoped to be enacted back in OBRA 87 this past December, but some final problems were not solved. They're in conference on it again this spring, and everybody expects that we will have legislation on this by no later than this summer.

Still on the topic of health benefits but moving a little further into the future, there has been a lot of discussion on Capitol Hill about prefunding retiree health benefits. The problem here is that this is a major liability for employers; the Financial Accounting Standards Board (FASB) soon will be requiring that this liability show up on an employer's financial statement. Employers are looking for some way to fund this, to create an asset to counterbalance this huge liability. The proposals that we are now hearing about (there's nothing that has been introduced to date) have some basic shared ideas. This is very much in the formative stage, but basically you would have some form of trust, you'd have tax-deductible prefunding of contributions, and you would have tax-free buildup of the amounts that are in the trust. In exchange for the tax advantages, there would be some kind of vesting requirement and also some type of participation requirements that would go with retiree health plans.

There are three basic approaches that are being considered at this point. The first is what's referred to as the pure defined benefit approach. Under this approach there is a promise of a stated benefit that the participant would receive at retirement. There are a couple of problems with this approach: (1) how does one accrue a health benefit of this nature; (2) how does one vest in a health benefit of this nature; and (3) how does one project the future cost for funding purposes, given the way health costs have increased tremendously over recent years and how much they're expected to increase over the next several years?

Another approach being considered is called the modified defined benefit approach. Under this approach there would be a fixed dollar amount that accrues annually. Whatever has been accumulated in total at the time the participant retires would be available to purchase or provide a health benefit.

A third approach is the pure defined contribution approach. This is similar to a profit sharing plan, with individual accounts for the participants. The employer would fund it. Whatever is in the employee's account at the time that he or she retires would be available to buy health benefits.

There is a fourth approach, in a bill that has been introduced, although it's not expected to go anywhere. This was introduced by Representative Rod Chandler of Washington. It's a defined contribution approach with a target benefit. This has level annual funding, aimed at a target; funding would be anywhere from $1,500 to $2,250 a year depending on the age of the participant.

The obvious advantage of the nondefined benefit approaches is that the employer's liability would be limited -- there would be no liability beyond making an annual contribution, which would take care of the FASB problem. The drawback with this approach, though, is that employees would not be protected. All that would be available for the purchase of health benefits would be whatever is

there in the account at the time the employee retires. Starting out 20 years before retirement, it is very difficult to say whether or not enough would be built up to purchase an adequate benefit.

Even though there is a lot of pressure for legislation of this type, the problem is it's a major tax expenditure. The government may not be willing to allow a few billion dollars a year to be contributed into these trusts on a tax-deductible basis, so although there is a lot of interest in this area, we don't expect Congress to be acting at anytime soon; our best guess is passage several years from now.

Continuing with health benefits, another big item is Senator Kennedy's mandated health benefits legislation. Under this, virtually all employers would be required to provide a basic health benefits package for their employees. What I'm describing to you now is the current version of the bill that is in the Senate; it was recently passed by the Senate Labor Human Resources Committee. However, given the fact that we don't expect to see anything enacted for probably five years, it's quite possible that all this will be massaged into something quite different from the following description. Under its current format, all employers who are subject to the minimum wage laws would be covered by this legislation. They would have to, in turn, cover all employees who are employed at least 17.5 hours a week. Coverage would be mandatory for all employees and their families; there would be some kind of coordination in which you had an employed spouse who was covered under another employer's plan.

The cost would be primarily paid for by the employer; no more than 20% of the premiums could be passed on to the employees. Moreover, employees earning less than $4.20/hour could not be charged anything for coverage. Deductibles would be limited: single employees $250/year (maximum), married employees $500/year (maximum). Copayments would be limited to 20% and there would be a maximum $3,000 stop-loss on all employee expenditures. There is also a provision that does allow the charge to employees to be increased, but that would only be permitted when the employer provides additional coverage above and beyond the minimum requirements; under those circumstances, the employer could pass the cost of that additional coverage on to the employees. So, for instance, if the employer offered a prescription drug program, then the cost of that program could be passed on to employees. Services covered under the legislation would be all medically necessary hospital care, physician care, diagnostic, prenatal, etc. The bill was recently amended just before it passed the Senate Labor and Human Resources Committee to provide for mental health care as well, although that was a very controversial item. Commencement of benefits would be within 30 days of an employee's employment. There could be no limitation for preexisting conditions on the health care coverage provided.

It's really uncertain when we'll finally see this. It's our sense that we will see legislation on this, though, sometime in the not too distant future, possibly as soon as 5 years from now.

Turning back to pensions, I want to close by discussing pension portability. This is another area where we don't see any legislation moving in the near term, but it's something that has a lot of interest right now. A lot of the presidential candidates have listed this as an issue and so we expect we can probably see something in the next 2-5 years. There is a bill that's been introduced by Representative Jeffords from Vermont; again this is a kind of a stalking horse to get the idea on the table and to get people to discuss it. The general

parameters of pension portability would require a vehicle called a portable pension plan. This would be much like the Individual Retirement Accounts (IRAs) we now have. It would be something maintained by financial institutions. It would provide, on behalf of a single individual, for investments in cash, in government securities, and in whatever other options are made available by the financial institution. Under the portable pension plan approach, a qualified plan could make an involuntary distribution (or involuntary transfer) within 90 days of a distribution event to a portable pension plan. If an employer has an employee who terminates employment, the plan could make a direct transfer of his accrued benefit to the portable pension plan, regardless of the size of the benefit and whether or not the employee consents, and thereby remove responsibility for the participant's accrued benefits.

Another provision that's being talked about as part of the pension portability legislation is the restriction of the availability of pension distributions to participants. Generally, it would prohibit any kind of distribution directly to an employee except in very limited circumstances. Those are the events listed in Section 72(t) of the Code, which is the provision for early distribution excise taxes. The exceptions to the early distribution excise tax would enable a participant to receive a benefit on termination; otherwise, if he did not fit within one of those exceptions, the distributions would not be available. Those exceptions are attainment of age 55, disability, extreme financial hardship, retirement, etc. Absent those exceptions, all that would be allowed when an employee terminates would be either a plan-to-plan transfer of the accrued benefits or a plan-to-portable pension plan transfer of the accrued benefits. Again, it's unclear when we'll see legislation on this because there is a lot that has to be worked out, but our guess is probably 3 to 5 years from now there'll be something in place.

MR. DYDO: Thank you, Seth, for your Capitol Hill update. Perhaps next year sometime, something of what you presented will be the law and will be the subject matter for recently issued regulations. Our next speaker is Jim Durfee. Jim is currently a Vice President with Towers, Perrin, Forster & Crosby (TPF&C), where he serves as assistant to the chief actuary. He consults for major clients and has the responsibility for technical leadership and training of his company's actuarial staff in the United States. He has also worked in the New York and the Pittsburgh consulting offices of TPF&C and in the home office of Mutual of New York. Jim received an A.B. degree from Brown and M.S. degree in Clinical Psychology from the University of Massachusetts in 1972. He is a Fellow of the Society and the Conference and an enrolled actuary.

MR. JAMES G. DURFEE: My topic deals with the Pension Protection Act, the recently enacted OBRA 87 legislation as it relates to pension plans. Unfortunately what I have to say is more in the area of questions and problems than it is in terms of latebreaking solutions. I will focus on two or three topics that are especially of concern to a number of enrolled actuaries whom I've talked to recently.

The first major area that I'd like to touch on is that of the quarterly contribution requirement. The recently introduced technical corrections make it clear that this quarterly requirement applies only to defined benefit plans; there was some question of defined contribution plan applicability, but it's apparently not applicable in this situation. There is still a major concern among defined benefit plans, because the first quarterly payment is due on April 15th of the year in question and is supposedly based on the lesser of 100% of the prior year's

minimum funding requirement or 90% of the current year's minimum funding requirement. However, in terms of major plans, the actuarial valuation will not have been completed by April 15th, so you don't know how much 90% of the current year's contribution is going to be.

There's been some concern expressed that if you base that first quarterly payment, and perhaps also the second and maybe even the third, on 100% of the prior year's minimum funding requirement, and you find after your valuation is completed that you've hit the full funding limitation and you have already put in more than the employer can take as a deduction for that year, what do you do? My first reaction to this problem was to consider that the contributions were contingent upon being deductible and since they're not deductible you'll take them back. However, Jim Holland said in the enrolled actuaries meeting earlier this year that the IRS's position is that a contribution contingent upon being deductible can only be refunded when the Service determines that it is not deductible. What he's saying is that that requires the contribution to be made, to be left in, to be claimed as a deduction and to, in a sense, wait until the plan or the employer has been audited and the contribution has been formally disallowed. So the Service's position, as we understand it, is that such a contribution can only be refunded when the Service has disallowed the deduction rather than when, for instance, the enrolled actuary has been willing to certify that it is in excess of the deductible amount.

At that time, Jim Holland essentially said that there was another alternative open in this situation and that would be simply not to make the quarterly contribution at all. In that case, the statutory penalty is essentially paying interest on that missed contribution into the funding standard account (that is, to yourself) at the rate of 175% of the federal midterm rate. Since that additional interest would also be deductible it does not seem like all that much of a problem. If you're concerned that a quarterly contribution might not be deductible, do not make it at all until the valuation has been completed.

Unfortunately, that is not the only penalty that is included in the Pension Protection Act for not making a required quarterly contribution. In fact, there is a notice requirement that within 60 days of missing a required contribution, every plan participant must be notified. I know of none of my clients who are interested in writing to their plan participants saying, "Oh, by the way, we violated the minimum funding requirement. It's no big deal, go right on your way." In fact, if the plan is less than 100% funded and the amount of the shortfall is in excess of a million dollars, there is a ten-day notice requirement to the PBGC which could in fact trigger a lien on the assets of the employer.

So this is an area that is still up in the air and we're hoping that Jim Holland will make some more comments on this in the session on the IRS. But it does not seem that there is any real "out" at this time in terms of the employer who wants to be sure that he's meeting the requirement and yet does not want to tie up money in excess of being deductible. In fact, it's very difficult with all these notice requirements to even comply with a notice requirement 60 days after an event occurred if you don't know that the event occurred. If you think that you're going to hit the full funding limitation and therefore aren't worried about making your contribution, and 60 days or 90 days or 120 days later find out you did not hit the full funding limitation, or you hit it only partially, then you have the same concern that you should have made notice to your participants and didn't and concern about what civil or criminal penalties might be applied to this kind of situation. My understanding is that Jim Holland has said these

concerns will be properly considered. In fact, he's not really in a position to promise anything more than that, because it seems to be a problem with the law rather than with any kind of interpretation the IRS could make. There does not seem to be any comment on this problem in technical corrections other than that it does not apply to a defined contribution plan.

The other area of concern that I wanted to bring up is that of contributory plans. Everyone loves employee contributions. At the time this new legislation was drafted, the idea of granting 120% of the federal midterm rate (which this year would be 10.61%) as interest on employee contributions had a great deal of appeal, especially as I understand it, to the committee and staff on the labor side of both the House and the Senate. But perhaps they didn't even realize what it was that they were getting into because that portion of the law that they amended did not really say that any employer in a contributory plan has to give 10.61% on refunds of contributions. What that portion of the law says is that in determining the employee-derived accrued benefit, which of course must be always be 100% vested, that 10.61% must be used to accumulate the contributions from the date that they are contributed (and it clearly appears that it's not retroactive before 1/1/88; it would be 5% before and 10.61% after) to normal retirement date. You then apply the purchase factors, including the 10% factor for a straight life annuity at age 65, and that determines the annual income associated with the employee-derived accrued benefit, again that must be 100% vested. The balance, if any (because that employee-derived accrued benefit does not have to be larger than the total accrued benefit), of the total benefit over the employee-derived accrued benefit is the employer-derived benefit, which is vested in accordance with one of the vesting schedules contained in ERISA or in the Tax Reform Act. But again, there never has been and there is not now any requirement that a contributory plan be required to grant a certain rate of interest on refunds of contributions. Granting interest on refunds is a separate issue.

In the past, most contributory plans did, however, grant 5% interest on refunds. Essentially the logic behind that was if you grant a refund with a statutory rate of interest, you can also rid yourself of the liability of paying off in the future any employee-derived accrued benefit. It sounds like those two things go together -- paying interest at the statutory rate and paying off the employee-derived accrued benefit. The logic of that approach was that you could accumulate these contributions at 5% all the way up to normal retirement age and then apply the plan's discount factor (which looked like it would be 5%) to come back today to give a lump sum value of that employee-derived accrued benefit. So, because that 5% interest is used both for accumulation and discounting when you pay back employee contributions with a statutory 5%, in the past, you no longer had to provide any employee-derived accrued benefit in the form of annuity.

Our understanding of the Service's position on this now is that under the Pension Protection Act, paying back employee contributions with a statutory rate of interest will not necessarily relieve the plan of the liability to pay any employee-derived accrued benefit. There may, in fact, be a residual. The lump sum necessary to completely pay off the employee-derived accrued benefit is the current employee contribution balance accumulated at 10.61% up to normal retirement multiplied by the statutory annuitization factor. That employee-derived accrued benefit does not have to be more than the total accrued benefit. The employee-derived accrued benefit should be discounted back at the factors contained in the plan, which the law says cannot be in the excess of the PBGC

rate. Therefore, if you are accumulating at 10.61% and discounting back at immediate and deferred PBGC rates, which might average 7% or below, you'll find that the lump sum necessary to pay off the entire employee-derived accrued benefit may be considerably larger than the contributions accumulated with 10.61% interest.

This is an area where we think there's going to have to be a lot more examples given in regulations because there is great deal of concern and, in fact, now employers are going to have to make a choice that they did not have in the past. That choice is: (1) do we want to refund employee contributions with some rate of interest, whether it's 10.61% or perhaps even 5% as it's been in the past, and have some residual employee-derived annuity payable at normal retirement, or (2) do we want to pay off the entire employee-derived accrued benefit knowing that it's going to cost more than just paying the employee contributions with a statutory rate of interest?

There does seem to be some equity associated with using the approach that the Service is describing because what really happens is that the lump sum uniformly ends up determined using PBGC immediate and deferred interest rates from an annuity value at normal retirement. Therefore you have a situation in which, if the employee-derived accrued benefit is half of the total, then the lump sum refund is half of what an otherwise required lump sum would be if you were paying off the total value. But it gets really kind of confusing and there are a lot of choices to give to your clients. In fact, I know a number of clients who have decided that what they want to do is keep the employee contribution refund rate at 5% and pay as an annuity any additional residual employee-derived accrued benefit that might be necessary.

The next area I wanted to mention concerns the technical corrections which Seth said were just introduced again recently. There are a large number of provisions in there affecting the Pension Protection Act, but there are three that I'd like to mention in terms of immediate concern to pension valuation enrolled actuaries. First of all, there's been some issue relating to the amortization period for gains and losses that are first valued as of 1/1/88. The change from 15-year amortization for gains and losses to five years is described in the law as being applicable for a plan year starting after 12/31/87, which may lead us to believe that it would be five years for a gain and loss first entering the funding standard account as of 1/1/88. The conference committee report, on the other hand, talks about it as if it were first applicable for gains and losses arising after 12/31/88. Well, is a 1/1/88 calculated gain or loss really a 1988 gain or is it a 1987 gain? Within technical corrections, the decision apparently was to permit this to be a 15-year amortization item. Gains and losses first measured in a 1/1/88 valuation are going to be attributed to 1987 and therefore amortized over a 15-year period. My impression was that the situation was cloudy enough that the Service wanted to say let's not have any real controversy about this. There are bound to be significant losses from the stock market crash and you'll have one last shot at spreading those losses over a longer period of time. The exception is not really for plan years beginning in 1988; it is for plan years with a 1/1/88 valuation.

The second comment that I would make about technical corrections addresses the calculation of current liability in which service prior to plan participation is phased in for recognition purposes over a five-year period. Technical corrections make it clear that this was intended to apply only to employees who have service in excess of the minimum required for plan participation. In other

words, you are not prorating over five years the one year of service that a person has when he comes in. It's really intended for situations in which you have a new plan or a plan amendment bringing in a block of people who have service in excess of the eligibility minimum.

Regarding these two provisions, this one and the 15-year amortization, I haven't talked to anyone at the IRS but I get the impression that they will probably be administering these as if the technical corrections were passed during the time period we're waiting to see whether or not they are passed, because they really represent ambiguities within the law rather than any substantive position change.

There is one item which I might consider a bombshell within technical corrections, which does not strike me as being particularly technical or particularly a correction. That is that the current requirement that a pension plan have an actuarial valuation at least once every three years will be changed to an annual valuation requirement. There is no explanation as to why an annual valuation is required, although we get the impression that all of the current liability calculations and so on are really just so complex and overwhelming that it would be very difficult to estimate these on a three-year basis. But it does appear now that if technical corrections are passed, a defined benefit plan will have to have an actuarial valuation every year rather than one every three years and two estimates in between.

FROM THE FLOOR: When would the last annual valuation provision be effective?

MR. DURFEE: I have been unable to get any clear kind of reading on that. It seems like something that we might have to ask Jim Holland about. I really don't know because, clearly, plans that did a valuation last year and were not expecting to do one this year, it would seem a burden to have to do one right away. If I had to guess I would say, probably 1989.

MR. DYDO: Thank you, Jim, for your scholarly analysis of current problems facing the consulting actuary who works with pension plans. Our final speaker is Ken Yednock. Ken is chief of the projects branch of the Employee Plans Technical and Actuarial Division of the IRS in Washington, D.C. The job that Ken has, or what the project branch does, is to produce revenue rulings, revenue procedures, IRS notices, and publications of that type. In addition, they review regulations. Ken has worked in legislative matters related to employee plans with the IRS for nine years. Before that he worked at the PBGC for about three years. He is a graduate of Drake University.

MR. KENNETH YEDNOCK: I'd like to start out first with just a preview of coming attractions, rather than talk about things that have been released by the treasury or the IRS relating to tax reform or OBRA 86 or OBRA 87. I'd like to talk instead about things that we're planning to do, things that are on the drawing board now (some that are very close to completion and others that are a little farther down the road) to give you an idea of what to expect. Maybe that will be of some help in planning, in talking to your clients, and in dealing with the many issues that you have to deal with.

All of these plans are subject to change and I won't be providing dates as to when a particular regulation might be issued. Regulations have to be approved by the Department of Treasury, which is the IRS's boss, in that area, and their time-tables are set there and I won't try to speculate as to what specific dates

might be. Many of the issues that we're dealing with in the regulatory process and in various other avenues of work may be changed due to suggestions, issues, or questions that are raised at conferences like this.

I'll speak about items unrelated to TRA 86 and OBRA 87. The first of these concerns the alternative forms of plan benefit regulations -- regulations dealing with 401(a)(4) of the Code and section 411(d)(6) of the Code, as to limitations on the availability of alternative plan benefits. The second nominee in this category would be the final Retirement Equity Act (REA) regulations. Interim regulations were issued in 1985 and the final REA regulations are on the forefront.

First, with respect to the alternative plan benefit regulations, proposed regulations regarding employer discretion with respect to alternative forms of plan benefits and discrimination with respect to the availability of alternative plan benefits were issued in 1986. Some people have been asking, since those were proposed regulations in 1986, whether any of the basic positions are being changed and whether that is why it's taking so long for these regulations to be finalized. The answer to that is no. The basic positions in those regulations will be retained in the final versions; in particular, under a qualified plan, alternative forms of benefits must be available on a nondiscriminatory basis, as was stated in those proposed regulations. Also, the employer discretion that could be used to deny a participant an alternative form of a plan benefit will not be acceptable in a qualified plan.

Since those proposed regulations came out in early 86, some major events have happened that have caused those regulations to be sidetracked, primarily TRA 86, OBRA 86, and OBRA 87. But final regulations should be out soon, and they will clarify the scope of what is an alternative form of plan benefit. There were a lot of questions in the hearings that were of help after those proposed regulations were issued and a lot of questions since then as to what is included in the scope. One of the issues that will be dealt with, at least in part, is the conversion of defined benefit plan liabilities into defined contribution plan liabilities and vice versa.

The effective dates in those proposed regulations have come and gone for many plans and have caused people to further ask these questions. The effective dates will be changed in the final regulations. Notice 88.6 threatened to do that. The final REA regulations will follow through on that threat and postpone the effective dates until sometime after the final regulations are published.

In addition, the final regulations will extend to plans and sponsors of plans Section 1140 treatment (under TRA 86), which required that plan amendments needed to comply with these final regulations as of the effective date of the regulations need not be made at that time. The actual plan amendment can be delayed and can be adopted at the end of this Section 1140 period, which is generally the last day of the first plan year beginning on or after January 1, 1989, with a further delayed date for collective bargaining plans, provided that these amendments, when adopted, are retroactively effective to the effective dates (which will be in these final regulations) and that during this period of time from the effective date to the time when the amendments are adopted the plans are operated in accordance with the qualification requirements and the plan amendments.

The interim REA regulations that are there now were issued in 1985, and there were things that have transpired in between. With the final REA regulations, though, some things are a little bit closer to home. First of all, TRA 86 amended some provisions that were covered in the final REA regulations, changing some provisions directly. Also, TRA contained some technical corrections to REA provisions, and the final regulations under REA will deal with the technical corrections, the TRA 86 changes, and questions and other problems that have arisen and were brought to our attention since then.

Now even though these two items are not TRA and are not OBRA 87 matters, they're considered highly important. They're on the front burners, they should be out fairly soon, and they're not going to be pushed back or side tracked for things that we know about currently, because we feel that there are important participant protections in these regulations and we definitely want to see them come out.

Let me return for a minute to the Section 1140 treatment. By extending the Section 1140 treatment to plan amendments that are required because of changes in the qualification requirements, the employers will be able to avoid the repeated rounds of plan amendments if they want to get the determination letters. On balance, we also think that for our processing of cases in the field this is an efficient way to operate. However, by extending this to various things that come down the pike, we're going beyond what is in the statutes that provide for this. TRA specifically provided for the Section 1140 treatment and OBRA 86 also provided for it. With Treasury, we have administratively extended it to a couple of other items, but in extending it, we're doing it because, on balance it seems to be the preferred approach by a number of employers and ourselves in a number of cases. But there are some risks, so don't forget the risks that are involved.

Operating a plan in accordance with provisions that haven't been written yet is a brave new world, at least for this period of time that the delay may involve. And so, plan administrators and consultants shouldn't just sit back and enjoy the delay and wait until the end of the 1989 plan year to start doing something about it and maybe even hoping that there might be a further extension and wait a little bit longer. The current advantage of being able to delay an amendment could result in a later disadvantage. Two or three years from now, when you are attending a conference like this, your clients may be visited by someone who is there to help them by performing an audit. This individual will be examining the plan and upon examination will presumably have the benefit of a written plan document at that time. This document may have been written at the end of 1989 or even later, but it is retroactively effective through 1987 and 1988; this individual will have the advantage of comparing the written document with the actual plan practiced during those years. So, this isn't really a time to sit back and wait. Some employers may want to go ahead and amend, put in some language, especially for the changes that are in effect in 1987 and the ones that go into effect in 1988.

As far as the changes, the big thing that is holding up quite a few other regulations is the need to get the 401(k) regulations out. There are two sets of regulations regarding the 401(k). One final set of 401(k) regulations is primarily a finalizing of the 401(k) regulations that were proposed in 1981. There is also a second set of 401(k) and 401(m) regulations dealing with the TRA 86 changes to those Code sections.

Once those regulations are out, we intend to open up the determination letter program to start passing on the qualification requirement changes that are pre-1989. We think that there will be adequate guidance at that time for sponsors to amend their plans, if they want to (some sponsors may want to start amending their plans then for at least the 1987 changes and the 1988 changes). Employers could still continue to use that treatment, and we're not discouraging by any means the use of the Section 1140 treatment, but some employers may feel that the disadvantages of not amending may outweigh the advantages. The program will be open following the 401(k) regulation issuance, and we would be passing on qualification requirements in effect prior to 1989. The only exception to that is addressed in Notice 86.13, which indicated that, with the exception of a couple of minor changes in TRA 86, the determination letters that your clients have been getting now do not provide reliance with respect to changes under TRA 86 or some of the qualification changes that have gone into effect in 1987 or 1988. One other batch of exceptions would be for terminating plans. Notice 87.51 and Revenue Procedure 88.9 prescribe that plans that are terminating are required to amend to comply with the qualification requirements in effect at the time of termination, in order to receive a favorable determination letter upon termination.

There are a couple of other items that are close to fruition. About a year ago we issued Notice 87.13, which dealt with a host of taxability and distribution matters and we have an offspring of 87.13, which will also deal with an array of distribution and taxation matters. We also have further guidance planned under Section 415 of the Code -- follow-up to Notice 87.21 and further guidance with respect to Code Section 415(e) in this application.

I'd like to talk now about the determination letter program for 1989. Obviously, the key to opening any determination letter program for the 1989 changes is the regulations. First of all, let's look at 401(l) permitted disparity. One reason why those regulations aren't out now is that we are dealing with the difficult issue of what is the relationship between 401(l) and what is permitted under 401(a)(4). What is discrimination, how will discrimination be tested, how will it be measured under 401(a)(4) after these changes in the law? Obviously, we think that 401(l) needs to be crafted and constructed in a consistent manner.

Also, 401(l) should bear some relationship to the descendent of Revenue Ruling 81.202 (RR 81.202), a standard for determining discrimination. In the conference reports, TRA 86 contained a number of references to RR 81.202, including some changes and updating that needed to be made. We also think it needs to be made consistent with what we're doing under 401(l). Probably one of the biggest areas where there's a lot of different ways to go, a lot of issues and matters to be resolved, is the transition rules. How does one get from a plan that met the requirements of RR 71.446 for years and now is going to be meeting the requirements of 401(l) in the future? What will be the transition? Will it be as difficult as all of you imagine, or could it possibly be a little bit better?

The next big regulation package would be the coverage regulations under 410(b). One of the main items there that needs to be completed is the average benefits test. There are things to be considered regarding the relationship of the average benefits test to 401(a)(4) and to to RR 81.202. Then, there is a new Code Section 401(a)(26) regarding minimum participation requirements. That regulation also is key to opening the 1989 determination letter program. What is a separate benefit structure? On a number of these pension laws you can ask some basic questions. The use of terms that people have been using for years

and years to define or distinguish has in the past proved not to be the easiest thing in the world to do.

What is a plan? There are a number of companies with large retirement programs where it's not even clear now if there is even one plan. This was long before 401(a)(26) came along. By using what 414(l) says, we can determine if there is one plan here. Well, there's a new layer to be added: even though there may be one plan for the purpose of 414(l), it could be that within this one plan, there's more than one plan for the purpose of 401(a)(26). Based on the conference report and the legislative history, I think that the statute clearly indicates that that could be the case. The question is how does one start drawing these lines and determining? Beyond determining how many plans within one plan exist, what about separate structures outside of a plan? Can they give rise to more than one plan within a plan? Those are the big issues that are still to be resolved in the 401(a)(26) package.

Next we have 414(r), the separate lines of business. The only problem in this area is drawing lines between lines of business. With respect to that regulation, we hope we can provide a number of safe harbors, or a safe harbor objective-type test, so that the majority of your clients will be able to fall into, or clearly know they're not in, the safe harbors. It may not be easy to deal with separate lines of business and all the myriad situations that people could conjure up, but hopefully we can deal with the majority of them.

Well that's what it takes in order to get the determination letter program opened. You get regulations out, you get guidance out, and say in these regulations that the people will have reliance on these regulations. I did mention earlier that some of the other regulations I referred to, the ones that have come out already (e.g., the highly compensated, employees' definition of compensation) did state in the preambles that employers could have reliance on the regulations and the Service will apply the regulations in examinations and determination matters. So, with these regulations out, and with reliance in them, we would be able to open up the 1989 program.

Now, regarding the 1989 program, one thing that is going to be new and different is the user's fees. We think that the user's fees may drive a number of people to our master and prototype program. What we're trying to do is put a little more flexibility into the master and prototype program for 1989 and maybe be able to accommodate more people.

Beyond the master and prototype program, as far as the field program goes, we're also looking into, and seriously considering, model amendments. Notice 87.2 mandated model amendments that would get plans through 1988. We will be working to try to come up with either a model amendment, or maybe pieces of model amendments, that employers might be able to adopt for their plans with reliance, or maybe, in part that would speed up the processing of a determination letter request in the field but not give total reliance. Also, we have under consideration an updated, modernized, streamlined, and fuel-efficient special reliance procedure. After ERISA was passed, there was a whole host of regulations coming out -- proposed regulations that needed a lot of work, other regulations that weren't out. The Service and Treasury tried a special reliance procedure. I think we've learned some things from that, and we're thinking that we have some of the same concerns and factors operating now. If it's possible, we are going to think about developing a special reliance procedure. If we come out with this new procedure one of the things that we know that

people will want is a longer period of reliance than existed under the first special reliance procedure. So, we're giving a lot of thought to a three-year period of special reliance and not needing to come back to amend the plan because of changes in regulations or Service positions, and there are also a number of other refinements.

More in line with the heading of this session, regarding late breaking developments, for those of you who want to get your last comments in or whatever on the user's fee Revenue Procedure, there will be a public meeting on May 19, in Washington, D.C., on that issue.

We put out an announcement recently, announcement 88.51, dealing with springing cash values. The Service has several concerns with what seems to be a relatively new insurance annuity type product or maybe a new way of promoting an older insurance annuity type product. The concerns stem from the fact that the product seems to be promoted on the basis of relatively low cash surrender values in the early years. That is, these nominal cash surrender values are quite low in comparison with the total amounts that are paid to the insurance company. There have been some promotions stating that this may be a way to lower the taxes upon a distribution of a contract from a qualified plan. Obviously there are concerns about the taxes. Beyond that, in the employee plans areas, as opposed to the taxation of the individual in the employee plans area, there are questions about whether a contract like this would meet the incidental test for insurance benefits. Further, there is a question about these being used solely with respect to highly compensated individuals rather than by nonhighly compensated individuals. There are also questions about the values of these with respect to the 415 limits. Are the 415 limits being observed? The announcement indicated that we do have these under study, that there will be further information provided.

Monday, in the Federal Register, regulations under OBRA 86 dealing with the changes to code section 410 and 411 on not reducing or eliminating accruals (including allocations in defined contribution plans) on account of age were issued. There was an announcement that came out, Notice 88.25, in February that stole the thunder from the regulations; it said that the regulations were going to have a retroactive effect. I guess I need to draw your attention to the notice and the regulations because of the retroactive effect in those regulations.

MR. DYDO: Thank you, Ken, for your regulatory updates and litany of the concerns that the IRS is dealing with before it really creates the proper regulations dealing with these rather complex issues.

MR. DONALD J. SEGAL: Mr. Yednock, about these Age Discrimination in Employment Act of 1967 regulations, were there any changes with respect to the retroactivity as stated in Notice 88.25; i.e., what was stated was that if you had one hour of service in the 1988 plan year, you must give retroactive credit from age 65 to the present time. Did the published regulations repeat that position?

MR. YEDNOCK: Yes, the published regulations repeated that position. Service is counted for purposes of determining the nonforfeitability rights that someone has, and then in certain cases, for certain plans, service is also counted for accrual purposes. In particular, for the one case that was mentioned, an individual who had not been a participant in the plan (for example, had been denied participation because of the maximum age condition), had never been a participant in the plan, but does have an hour of service in the plan year beginning

on and after January 1, 1988, would receive credit for years of service for purposes of nonforfeitability but would not be required to have years of service credited for accrual of plan benefits. So the regulations provide a little bit more specificity than the Notice did.

MR. STEVEN M. RIETH: As a follow-up to that last question, what does the regulation say about computation of allocations to a person past the normal retirement age in a target benefit plan?

MR. YEDNOCK: They don't say very much. That's an area where, since we didn't have final answers yet, we need to do a little bit more work; but we didn't want to hold up the regulations solely for that. The regulations indicate that they don't say much about target benefit plans, but we'll try to, as soon as we can.